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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1929.

No. 311.

WALTER A. MAY, ET AL., EXECUTORS OF PAULINE MAY,

vs.

D. B. HEINER, COLLECTOR OF INTERNAL REVENUE.

## BRIEF OF ARTHUR W. MACHEN, JR., Attorney for SAFE DEPOSIT AND TRUST COMPANY OF BALTIMORE, Amicus Curiae.

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## BRIEF OF ARTHUR W. MACHEN, JR., Attorney for SAFE DEPOSIT AND TRUST COMPANY OF BALTIMORE, Amicus Curiae.

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### Statement of Facts.

The case made by the "Statement of Claim" (R. 2-9) and the exhibits therewith filed (R. 9-31) is briefly as follows:

Pauline May, on May 15, 1917, executed an agreement under seal to transfer certain property to trustees upon trusts therein outlined, and covenanted to execute a more formal instrument of trust (R. 12).

On October 1, 1917, she executed a formal agreement or deed of trust (R. 13-16), transferring certain securities therein mentioned to the same trustees upon almost identical trusts, viz: in trust to pay the income to Barney May, her husband, for his life, and thereafter to the grantor if she should survive him for her life, and upon the death of the survivor to transfer the corpus to their four children, equally, or the issue of such of them as might be then deceased. The only substantial difference between the trusts declared is that the paper of October 1, unlike the

informal paper of May 15, gave to each child who should die before the survivor of the grantor and her husband, a power of testamentary appointment over his or her share. No power of revocation or alteration or management was reserved to the grantor. Both instruments were executed while the Act of September 8, 1916 (39 Stat. 756, 777-780) as amended by the Act of March 3, 1917 (39 Stat. 1000, 1002) was in force, and before the passage of either the Revenue Act of 1918 (40 Stat. 1057, 1096-1101) or the Revenue Act of October 3, 1917 (40 Stat. 300).

The Record does not distinctly disclose whether the Deed of October 1, 1917, was simply the "formal instrument of trust" contemplated in the earlier paper, or whether the two instruments were separate and independent transfers. We assume that the former was the case, as the Commissioner valued at zero the property passing under the earlier instrument (R. 21).

Pauline May died on March 25, 1920, when the Revenue Act of 1918, approved February 24, 1919 (40 Stat. 1057, 1096-1101) was in force.

The Commissioner of Internal Revenue included the property passing under these instruments in the gross estate of the decedent for purposes of the Estate Tax under the Revenue Act of 1918; and accordingly collected an alleged deficiency of $5,524.42 (R. 18, 7) which the plaintiffs, executors of Pauline May, paid under protest on September 11, 1923 (R. 8). After claim for refund duly filed (R. 27-9), which was refused on February 20, 1924, by the Commissioner (R. 8, 29-31), the plaintiffs as executors instituted this suit on July 15, 1924 (R. 1).

A motion to strike out the Statement of Claim (R. 31), was granted and judgment entered for the defendant by the District Court (R. 38). The Circuit Court of Appeals for the Third Circuit affirmed this judgment on a *per curiam* opinion (R. 41), 32 Fed. (2d), 1017. The case is before this Court on writ of certiorari granted on October 21, 1929 (R. 43).

The only question is whether the property passing under the two instruments above mentioned is to be included in the gross estate for purposes of Estate Tax under the Revenue Act of 1918, (sec. 402 (c), 40 Stat. 1097), as property of which the decedent had made a transfer or created a trust intended to take effect in possession or enjoyment at or after her death. The transfers were made more than two years before Mrs. May's death and there is no claim or suggestion that they were in contemplation of death.

The Record does not distinctly show that Barney May survived his wife, the grantor, Pauline May, so that she did not in her lifetime receive any of the income or enjoy any benefit from the trust property after the execution of the deeds. But as it appears that he was living when the deeds were executed and as there is nothing to indicate that he died before his wife, the presumption is that he was still living when she died. At all events, it is stated in the Petition for Certiorari (p. 3) that he survived his wife and actually joined in filing the estate tax return as one of her executors, and certainly after his wife's death the Commissioner addressed to him a letter as one of the executors of his wife (R. 18). We stress this point because in the view we take of the case, the fact of his survivorship is of *very great importance.* The case would have been very different if Barney May had predeceased his wife, and if she had thus become entitled to the usufruct of the property during her life.

We respectfully submit:

1. That Section 402(c) of the Revenue Act of 1918, if construed to apply retroactively to transfers such as those in this case, is to that extent unconstitutional under the Fifth Amendment.

2. That the Act of 1918 is unconstitutional in so far as it may apply to transfers of the kind involved in this case, though made after its passage.

3. That the transfers in this case passed both possession and enjoyment from Pauline May in her lifetime, and did not take effect either in possession or enjoyment at or after her death.

## I.

**Sec. 402 (c) of the Revenue Act of 1918 in so far as it Applies to Irrevocable Transfers Executed Before its Passage Merely Because They Were Intended to Take Effect in Possession or Enjoyment After the Grantor's Death is Arbitrary, Capricious and Confiscatory, and Therefore in Conflict With the Fifth Amendment.**

*Historical Summary of Pertinent Portions of Estate Tax Legislation Down to Act of 1918.*

Section 402(c) of the Revenue Act of 1918 is applicable by its terms to transfers intended to take effect in possession or enjoyment at or after death "whether such transfer or trust is made or created before or after the passage of *this Act.*"

The prior estate tax law—that is to say, the Act of September 8, 1916 (39 Stat. 756), as amended by the Act of March 3, 1917 (39 Stat. 1002), with the additions thereto made by the Act of October 3, 1917 (40 Stat. 300), did not contain the words printed in quotation marks in the foregoing paragraph, but was expressed to be applicable merely to property in respect of which the decedent "has at any time made a transfer" of the character specified. This Court held that the Act of 1916 by its proper construction was not intended to be retroactive so as to tax transfers executed before it was passed.

Shwab v. Doyle, 258 U. S. 529;
Union Trust Co. v. Wardell, 258 U. S. 537;
Levy v. Wardell, 258 U. S. 542;
Knox v. McElligott, 258 U. S. 546.

It being apparent by reason of the words "whether such transfer or trust is made or created before or after the passage of this Act" in the Revenue Act of 1918, that *that* Act was intended to apply retroactively to transfers of the kind specified made prior to its passage, the constitutionality of the Act in that respect was challenged in *Nichols v. Coolidge*, 274 U. S. 531; and the conclusion of this Court was expressed as follows:

> "We must conclude that Section 402(c) of the statute here under consideration,"—*i.e.*, the Revenue Act of 1918, approved February 24, 1919 (40 Stat. 1057)—"in so far as it requires that there shall be included in the gross estate the value of property transferred by a decedent prior to *its passage*"—*i. e.*, the passage of the Act of 1918 on February 24, 1919—"merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious and amounts to confiscation. Whether or how far the challenged provision is valid in respect of transfers made subsequent to the enactment, we need not now consider" (274 U. S. 542-3).

The "statute here under consideration" was the Revenue Act of 1918, approved February 24, 1919. In a previous part of the opinion the Court quoted in full the "relevant portions of 'Title IV—Estate Tax' Act, February 24, 1919" (274 U. S. 534-6).

It is said, however, that the transfers involved in *Nichols vs. Coolidge*, were executed long prior, not merely to the passage of the Act of 1918, but also to the passage of the Act of 1916, and that the language of the Court should be construed as applicable only to transfers prior to September, 1916, and is at any rate a mere *dictum* so far as it may apply to transfers after September 8, 1916.

It is, indeed, almost inconceivable that this Court used the language "prior to *its* passage" inadvertently, and without considering the distinction between transfers executed before and after September 8, 1916; for one of the points most strongly emphasized by the defendants in error in *Nichols vs. Coolidge*, as well as in briefs of *amici curiae*, was that

the provision of the Act of 1918 that transferred property should be included "whether such transfer or trust is made or created before or after the passage of this Act" should be construed to apply only to such transfers prior to the passage of the Act of 1918 as were made subsequent to the passage of the first Federal Estate Tax Law—*i. e.*, subsequent to September 8, 1916. See brief for the Defendants in Error in *Nichols vs. Coolidge*, p. 27, and brief of Mr. Russell L. Bradford, *amicus curiae*, pages 13 to 20.

This Court overruled this point as to the construction of the Statute; and, its attention having been thus directed to the question of transfers made before the passage of the Act of 1918, but after September 8, 1916, concluded its discussion with the declaration that the Act is unconstitutional as to any such transfers made "prior to *its* passage" —*i. e.*, the passage of the Act of 1918.

As, however, the transfers involved in *Nichols vs. Coolidge* were executed before the passage of the Act of 1916, anything which fell from this Court as to transfers after September 8, 1916, and before February 24, 1919, may be in a sense a *dictum;* and therefore we shall endeavor to show that on principle there is no justification for distinguishing in this regard between transfers before and after September 8, 1916.

The Revenue Act of September 8, 1916, Title II, (39 Stat. 756, 777), imposed a graduated estate tax at rates ranging from 1% on "net estates" of less than $50,000 to 10% on estates of over $5,000,000. The Act of March 3, 1917 (39 Stat. 1000, 1002), amended this act by increasing the rates from 1½% in the lowest bracket to 15% in the highest. The amendatory act provided however that the estates of persons dying before its passage but after September 8, 1916, should continue to pay the old rates.

This was the state of the law when the informal trust agreement of May 15, 1917 (R. 12) and the more formal settlement of October 1, 1917 (R. 13-16) were executed.

Two days after the execution of the latter instrument, the Revenue Act of October 3, 1917 (40 Stat. 300) was

passed; and Title IX of this Act imposed an additional "War Estate Tax" on the estates of all persons thereafter dying, at rates beginning with ½% in the lowest bracket and going up to 10% on estates of more than $10,000,000 (40 Stat. 324). This act did not further *amend* the Act of 1916, but superadded a new and additional tax, as distinct from the ordinary estate tax as the Excess Profits Tax was from the Income Tax.

The combined rates of the ordinary Estate Tax and of the War Estate Tax began with 2% in the lowest bracket and ran up to 25% on estates of over $10,000,000.

Now, we opine that under the rule enunciated in *Nichols vs. Coolidge,* 274 U. S. 531, that a *retroactive* tax *of this kind* on transfers irrevocably made before the passage of the taxing act merely because the transfer was to take effect in possession or enjoyment at or after death is unconstitutional, there can be no reasonable doubt that if Pauline May had died while the Act of October 3, 1917 was in force, the new and additional tax imposed by that act could not have been collected from her estate, in respect to this transferred property. Her estate would have been subject to the tax imposed by the Act of September 8, 1916 as amended by the Act of March 3, 1917; and for purposes of *that tax* the transferred assets could have been constitutionally included in the gross estate, unless as urged *infra* pp. 20-7 the Act is unconstitutional even as to transfers executed after its passage. But the additional tax imposed by the Act of October 3, 1917, could not have been constitutionally applied retroactively to an irrevocable transfer made before its passage; and for the purposes of *that tax* the transferred assets could not have been included in the "gross estate."

Similarly, if an irrevocable transfer had been made after September 8, 1916, and before March 3, 1917, and the grantor had died while the amendatory act of the last mentioned date was in effect, it might have been possible to hold

that the *amendment* was unconstitutional as to the transferred property, leaving the lower rates fixed by the Act of 1916 applicable to the transferred property.

But before the death of Pauline May on March 25, 1920, the Revenue Act of 1918 (40 Stat. 1057) was passed. This Act (Sec. 1400 (a), 40 Stat. 1149) repealed outright Title II, called "Estate Tax" of the Act of 1916, Title III, called "Estate Tax" of the Act of March 3, 1917 (being the amendment increasing the rates imposed by the Act of 1916); and Title IX, called "War Estate Tax" of the Revenue Act of October 3, 1917, which imposed the separate and additional tax. In spite of the repeal, it was declared that the said repealed provisions should "remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes" (Revenue Act of 1918, Sec. 1400 (b), 40 Stat. 1150). There was also a provision that the method of assessing and collecting estate taxes previously accrued under the Act of 1916 as amended by the Act of March 3, 1917, or under the Act of October 3, 1917, should be according to the Revenue Act of 1918.

But, for the future, the Revenue Act of 1918 provided in substance a *totally new system* differing in rates and in basis both from the Act of 1916 as originally passed and as amended by the Act of March 3, 1917, and from those acts as supplemented by the extra "War Estate Tax" imposed by the Act of October 3, 1917.

The following is a table of rates as imposed by the various Acts:

| Amount of Net Estate. | Act of Sept. 8, 1916. | Act of March 3, 1917. | Act of Oct. 3, 1917, plus the Act of March 3, 1917. | Revenue Act of 1918. |
|---|---|---|---|---|
| Up to $50,000 | 1% | 1½% | 2% | 1% |
| $50,000 to $150,000 | 2 | 3 | 4 | 2 |
| $150,000 to $250,000 | 3 | 4½ | 6 | 3 |
| $250,000 to $450,000 | 4 | 6 | 8 | 4 |
| $450,000 to $750,000 | 5 | 7½ | 10 | 6 |
| $750,000 to $1,000,000 | 5 | 7½ | 10 | 8 |
| $1,000,000 to $1,500,000 | 6 | 9 | 12 | 10 |
| $1,500,000 to $2,000,000 | 6 | 9 | 12 | 12 |
| $2,000,000 to $3,000,000 | 7 | 10½ | 14 | 14 |
| $3,000,000 to $4,000,000 | 8 | 12 | 16 | 16 |
| $4,000,000 to $5,000,000 | 9 | 13½ | 18 | 18 |
| $5,000,000 to $8,000,000 | 10 | 15 | 20 | 20 |
| $8,000,000 to $10,000,000 | 10 | 15 | 22 | 22 |
| Over $10,000,000 | 10 | 15 | 25 | 25 |

This, however, is only half of the story; for the Revenue Act of 1918 radically altered the method of computing the "net estate" on the transfer of which the tax is laid, so that in many cases a lower rate produced a larger tax.

The following are a few examples:

(1) The Revenue Act of 1918, unlike the Act of 1916, either as originally passed (*Shwab v. Doyle*, 258 U. S. 529; *Union Trust Company v. Wardell*, 258 U. S. 537; *Levy v. Wardell*, 258 U. S. 542; *Knox v. McElligott*, 258 U. S. 546) or as amended by the Act of March 3, 1917, and unlike the Act of October 3, 1917 (which applied to the same basis of taxation as the earlier acts) undertakes to include, retroactively, in the gross estate the value of property previously transferred in contemplation of death or to take effect after death (Revenue Act of 1918, Sec. 402(c), 40 Stat. 1097).

(2) The Revenue Act of 1918, unlike the earlier acts (*United States v. Field*, 255 U. S. 257) requires property passing under exercise of a general power of testamentary appointment to be included in the gross estate (Revenue Act of 1918, Sec. 402(e), 40 Stat. 1097).

(3) The Revenue Act of 1918 (Sec. 402(f), 40 Stat. 1097) requires that the gross estate shall include insurance taken out by the decedent on his own life and payable to his executor or (in excess of $40,000) to any other person; but none of the prior laws contain any similar provision.

(4) The Revenue Act of 1918 (Sec. 402(b), 40 Stat. 1097) provides that the interest of a surviving spouse by way of dower, curtesy, etc., shall be included in the gross estate; but no prior act contained any such provision.

(5) The Act of 1918 (Sec. 403(a)1, 40 Stat. 1098) forbids the deduction of income taxes upon income received after the death of the decedent, or any estate, succession, legacy or inheritance taxes; but the earlier laws contained no such clause.

(6) The Act of 1918 (Sec. 403(a)2, 40 Stat. 1098) allows a deduction for the value of property previously taxed, as part of the estate of another decedent dying less than five years earlier, under this Act or the Act of October 3, 1917; but no similar deduction was permitted by any former Act.

(7) The Act of 1918 (Sec. 403(a)3, 40 Stat. 1098) allows a deduction for charitable, etc., bequests; but no such deduction was previously permitted.

(8) The Act of 1918 (Sec. 403(b)1, 40 Stat. 1098) provides that in case of non-resident decedents, not more than 10% of the value of the gross estate situated in the United States shall be deducted for debts, etc., whereas in the earlier laws no limit was fixed.

Sundry other differences of greater or less importance might be pointed out.

At all events, it is clear that irrespective of any question of rates of tax it might often be better to be taxed under any of the earlier acts, even the Act of October 3, 1917, and *a fortiori* the Act of March 3, 1917, which was in force when Mrs. May's transfers were made, rather than under the Act of 1918, under which it is now sought to tax her estate.

For instance, suppose property worth $1,000,000 was settled upon the decedent with a general power of testamentary appointment, and he leaves $50,000 which he owned outright and having exercised by will the power of appointment. Under the Act of 1916 either as originally passed or as amended and added to by the Acts of 1917, there would be no tax. But under the Act of 1918 there would be a tax of $51,500.

If such a person on, say, October 30, 1917, had transferred his $50,000 to a trustee in trust for himself for life, with remainders over, he could do so with the assurance that no tax would be payable in respect of the transferred property under the existing law; but the Act of 1918, if valid, would sweep away the entire trust fund from the beneficiaries, whose rights had vested at the time the deed was executed.

Many other illustrations of the same kind might be given in which there would be in all respects the same injustice in applying the Act of 1918 retroactively to transfers made between September 8, 1916, and February 24, 1919, as if the transfer had been made prior to September 8, 1916, when the first estate tax law took effect.

It may be said, indeed, that there is nothing to show that the changes in the *basis* of taxation—*i. e.*, the method of computing the "net estate"—made by the Revenue Act of 1918 operated to the prejudice of this estate, so that her estate being less than $750,000, the Act of 1918 may have actually reduced the tax which would have been payable under the Act of March 3, 1917, which was in force when the transfers were made. But of course, it would be impossible in each individual case to ascertain whether the Act of 1918 or the Act in force at the time of the deed would produce the heavier tax, and hold the Act valid or invalid according as it would produce in the particular case a smaller or a larger tax. The fact is that on large estates, the Act of 1918 is almost sure to be more onerous than the Act of March 3, 1917, and on small estates it may or may not be more onerous according to circumstances.

The only possible course, therefore, is to hold that Section 402(c) of the Act of 1918 in so far as it requires that there shall be included in the gross estate the value of property transferred by the decedent "prior to its passage," because the decedent reserved the income for his life, is wholly unconstitutional.

*Action of Treasury Department and Board of Tax Appeals.*

After *Nichols v. Coolidge*, 274 U. S. 531, amendments to Treasury Regulations 63 (as to the Act of 1921), Regulations 68 (as to the Act of 1924), and Regulations 70 (as to the Act of 1926) were promulgated which undertake to apply those acts retroactively to all transfers made after September 8, 1916, even though made before the passage of the particular act in question.

T. D. Nos. 4064, 4065 and 4066, Cum. Int. Rev. Bull. VI-2, pp. 345-6, 340-1, 337-8.

Even the Treasury Department, however, has not presumed to make similar amendments to Regulations 37, relating to the Act of 1918, which this Court explicitly declared to be unconstitutional as to transfers executed prior to "its passage," and which is the Act involved in this case.

Moreover, the Board of Tax Appeals has refused to follow these amended regulations, and has repeatedly applied *Nichols v. Coolidge* to transfers made before the passage of the Act under which the tax is sought to be levied, even though made after September 8, 1916.

Alsop v. Comm'r of Int. Rev., 7 B. T. A. 848 (as to Act of 1921);

Duggan, Executor, v. Comm'r. of Int. Rev., 8 B. T. A. 482 (as to Act of 1921);

Northern Trust Co., Executor of Van Schaick, v. Comm'r of Int. Rev., 9 B. T. A. 96 (as to Act of 1921);

Johnson v. Comm'r of Int. Rev., 11 B. T. A. 534 (as to Act of 1921);

McCormick v. Comm'r of Int. Rev., 13 B. T. A. 423, 436 (as to Act of 1924);

Morsman v. Comm'r of Int. Rev., 14 B. T. A. 108 (as to Act of 1924);

Pacific S. W. Trust, etc., Bk., Executor of Sykes, v. Comm'r of Int .Rev., 16 B. T. A. 1437, modifying S. C., 14 B. T. A. 1372 (as to Act of 1921).

The impossibility of construing the Revenue Acts of 1918 or 1921 as continuations of the pre-existing laws and the necessity for regarding them as entirely new enactments, is illustrated by—

Harris v. Comm'r of Int. Rev., 5 B. T. A. 41.

In that case, the decedent in 1912 had taken out a policy of insurance on his own life, but by changing the beneficiary had made it payable to his wife on September 30, 1920. Under the Act of 1918, which was in force at the time of the change of beneficiary, the proceeds of this policy in excess of $40,000 would have been liable to estate tax as part of his estate; but the Revenue Act of 1921 repealed the Act of 1918, as the Act of 1918 had repealed the Act of 1916, although repeating *in totidem verbis* the insurance provisions of the Act of 1918. This Court had held that the Act of 1918 was not retroactive as to insurance policies taken out before its enactment unless the beneficiary had been changed after its passage (*Lewellyn v. Frick*, 268 U. S. 238); and the Board of Tax Appeals held that the same construction must be given to the Act of 1921, although the result was that a policy which (at least in the view of the Board) would have been taxable if the Act of 1918 had continued in force, escaped taxation. The opinion states:

> "We are of the opinion that with the repeal of Title IV of the Revenue Act of 1918, the authority to include in the gross estate the proceeds of the policy of insurance here in question was lost and that the right ceases and determines with the statute upon which it depends. The effect of the repeal of Title IV of the Revenue

Act of 1918 was to obliterate the repealed statute just as completely as if it had never been enacted into law, and it must be considered as a statute that never existed, except for the purpose set forth in Section 1400(b) of the Revenue Act of 1921" (5 B. T. A. 44).

*This decision was acquiesced in by the Commissioner of Internal Revenue.*

Cum. Int. Rev. Bull, VI-1, p. 3.

*Answers to Arguments for Defendant.*

The argument for the Defendant must be that although, as held in *Nichols v. Coolidge,* 274 U. S. 531, Congress has no power retroactively to impose a tax of this kind on irrevocable transfers previously executed, yet if it has once adopted an estate tax it may retroactively increase the rates and change the basis even as to transfers irrevocably made before the passage of the amendatory act. The argument must be that the presence of any estate tax on the statute books operates as a red flag to warn every citizen that the rates may be increased and the basis changed, so that the provision of the Fifth Amendment (as construed in *Nichols v. Coolidge,* 274 U. S. 531) against retroactive legislation of this kind may be circumvented.

If this argument needs any answer, it may be found, we submit, in—

Untermyer v. Anderson, 276 U. S. 440.

This Court there held that even the pendency of a bill in Congress retroactively taxing gifts is not such a warning to taxpayers as to avoid the prohibition of the Fifth Amendment against a retroactive tax of this sort, or make the tax constitutionally applicable to a gift made only a week before the bill was signed by the President.

Mr. Justice McReynolds, delivering the opinion of the Court said:

> "The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee and ought not to be required to guess the outcome of pending measures" (276 U. S. 445-6).

If this be true, how could Mrs. May "be required to guess" that Congress would increase the rates in force at the time of her gifts from a maximum of 6% on a net estate of some $300,000 to 8% as was done by the Act of October 3, 1917, or that Congress would increase the basis by requiring the inclusion of property passing under a general power of testamentary appointment, property passing to her husband by courtesy or the like, and the amount of insurance taken out on her own life, as was done by the Revenue Act of 1918?

Reliance is placed by the Government on cases such as *Bear Lake Irrigation Co. v. Garland*, 164 U. S. 1, 11-12 and *Steamship Co. v. Joliffe*, 2 Wall. 450, 459, holding that when a statute is repealed and simultaneously re-enacted in substance, but with minor changes, the repeal and re-enactment operate substantially as an *amendment*, so that as to transactions covered by the old law it may be enforced with the amendments.

But such cases have nothing to do with the question of *constitutional power*. They raised,—at least this branch of them raised—no constitutional question whatsoever.

They give absolutely no countenance to the contention that Congress can circumvent a prohibition of retroactive legislation of any kind by passing it either as an amendment to, or as a repeal and re-enactment of, existing legislation.

For example, who has ever supposed that the constitutional prohibition of *ex post facto* laws can be got around by making an amendment to existing laws?

Who has ever dreamed that the prohibition of that form of retroactive legislation known as laws impairing the obligation of contracts can be evaded by calling the impairment of obligation an *amendment* to existing laws? Indeed, the Dartmouth College Case itself (4 Wheat. 518)

invalidated an *amendment* to the charter of Dartmouth College.

If such cases as *Bear Lake Irrigation Co. v. Garland, supra,* had *any* bearing on the case at bar, they would lead to the conclusion that the Act of 1916 as amended by the Act of March 3, 1917, should be applied to Mrs. May's Estate, with only such changes as could constitutionally be made.

But this, of course, was not what the Bureau of Internal Revenue did in the present case. No one claims that the Act of 1916 as amended should apply. The decision of the lower court is, not that the Act of 1916 as amended by the Act of March 3, 1917, should apply, but that the Act of 1918 should apply *in toto*—both as to rate and basis, including property irrevocably transferred before its passage. Our point is that this is forbidden by the Fifth Amendment as construed in *Nichols v. Coolidge,* 274 U. S. 531, and *Untermyer v. Anderson,* 276 U. S. 440. That contention is not affected by the question whether the Act of 1918 can be regarded under the rule in the Bear Lake Irrigation Case as an amendment to the Acts of 1916 and 1917. The contention would be just as strong if the Act of 1918 were an amendment.

We do not believe, however, that the Act of 1918 is within the rule in the Bear Lake Irrigation Case. It is in form at least entirely new legislation, expressly declared to be "in lieu" of all the earlier tax laws. It is not substantially the same, but radically different, both as to the basis and as to the rate of taxation.

It would be perfectly impracticable to hold that the Acts of 1916 and 1917 remain in force as to Mrs. May's Estate except as constitutionally altered by the Act of 1918. Congress contemplated but one estate tax, not two, on Mrs. May's Estate. There is no doubt that as to all property except the transferred assets, the tax must be computed under the Act of 1918, and it would defeat the intention of Congress to compute separately a tax on the transferred

assets under the Act of 1916 as amended by the Act of March 3, 1917.

Perhaps it would have been constitutionally possible for Congress to declare that a tax should be computed under the Act of 1918 but excluding the transferred assets from the gross estate, and that another tax should be computed under the Act of 1916 as amended by the Act of March 3, 1917, including the transferred assets as part of the estate, and that the higher of the two should be paid. *But most certainly it has done nothing of the kind.* The courts, it is submitted, cannot rewrite the law so as to produce that result.

Indeed, the intention of Congress that the Acts of 1916 and 1917 should be *altogether inapplicable* to Mrs. May's estate is clear. Section 401 of the Revenue Act of 1918 provides as follows:

> "Sec. 401. That (in lieu of the tax imposed by Title II of the Revenue Act of 1916, as amended, and in lieu of the tax imposed by Title IX of the Revenue Act of 1917) a tax equal to the sum of the following percentages of the value of the net estate (determined as provided in Sec. 403) is hereby imposed upon the transfer of the net estate of *every decedent dying after the passage of this Act*, whether a resident or a non-resident of the United States."

As Mrs. May died after the passage of the Act of 1918, it is clear that her estate is subject to the tax imposed thereby, and that the tax so imposed is "in lieu" of any tax imposed under the Acts of 1916 and 1917. Congress has clearly declared that the Acts of 1918, and it alone, shall govern Mrs. May's estate. In so far as it can not constitutionally apply thereto, there is no law in force taxing the same.

Further, Section 1400 of the Revenue Act of 1918 provides as follows:

> "Sec. 1400. (a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b): * * *
>
> "(1) The following titles of the Revenue Act of 1916: * * *

"Title II (called 'Estate Tax'); * * *

"(2) The following parts of the Act entitled 'An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes,' approved March 3, 1917:

"Title III (called 'Estate Tax'); * * *

"(3) The following titles of the Revenue Act of 1917: * * *

"Title IX (called 'War Estate Tax'); * * *

"(b) Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of any such part of an Act shall be available for the administration of this Act or the corresponding provision thereof: * * * Provided further, That the assessment and collection of all estate taxes, and the imposition and collection of all penalties or forfeitures, which have accrued under Title II of the Revenue Act of 1916 as amended by the Act entitled 'An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes,' approved March 3, 1917, or Title IX of the Revenue Act of 1917, shall be according to the provisions of Title IV of this Act. In the case of any tax imposed by any part of an Act herein repealed, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act."

Now Congress has expressly declared that the Acts of 1916 and 1917 shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and until the estate tax imposed in lieu of the taxes imposed by the earlier Acts shall take effect under the provisions of the Act of 1918. As Mrs. May was not dead at the date of the passage of the Act of 1918, so that no tax had ac-

crued under the Acts of 1916 and 1917, and as before she died the Estate Tax imposed by the Act of 1918 had taken effect, this provision is not applicable.

Congress has in effect said that the Acts of 1916 and 1917 shall be repealed except as to the estates of persons dying before the passage of the Act of 1918, and that even in that case the method of assessing and collecting the taxes imposed by the earlier laws shall be according to the Act of 1918.

Having therefore expressly declared that the Acts of 1916 and 1917 shall remain in force for a particular purpose which does not touch the case at bar, Congress has by necessary implication declared that the Acts of 1916 and 1917 shall not remain in force for any other purpose. *Expressio unius exclusio alterius.*

Some difference of judicial opinion has existed as to whether the parallel clause in the Act of 1921 had the effect of relieving from any payment of tax the estates of persons who had died within one year prior to the passage of the Act of 1921. The contention that it did so was based on the provision of the saving clause in the Act of 1921 to the effect that the Act of 1918 should remain in force for the assessment and collection of all taxes which had "accrued" under the Act of 1918. It was contended that a tax could not be said to have accrued until it was due. This argument prevailed in *Wilmington Trust Co. v. U. S.*, 28 Fed. (2d), 205, but the weight of authority is to the contrary.

Hanna v. United States, Court of Claims, decided Nov. 4, 1929;
Flannery v. Willcuts, 25 Fed. (2d), 951;
Page v. Skinner, 298 Fed. 731.

Both lines of authorities, however, agree that the earlier Act is absolutely repealed except as to matters within the saving clause—the only point in these cases bearing upon the matter now in hand. The Court of Claims, after quoting the saving clause, said:

> "A casual survey of the provisions set forth above clearly shows that the intent and purpose of Congress

was that the estates of all those who died prior to the enactment of the 1921 Act should be taxed under the 1918 Statute, and the estates of those who died after the enactment of the 1921 Act taxed under the provisions of the later Act. In fact, this intent is so plain that he who runs may read and understand."

The Board of Tax Appeals, in reaching the same conclusion, fully recognized that the earlier act is absolutely repealed except as to cases within the saving clause:

> "The question is thus narrowed to whether the tax involved here had accrued on November 23, 1921. If it had not accrued, the decedent's estate is not subject to any estate tax, regardless of the amount of the net estate."
>
> Guaranty Trust Co. v. Commr. of Int. Rev., 16 B. T. A. 314, 317-8.

If, therefore, as we contend, the Act of 1918 can not constitutionally be applied to transfers irrevocably consummated by Mrs. May before its passage, it follows necessarily that those transfers can not be taxed at all.

## II.

**The Revenue Act of 1918 is Arbitrary, Capricious and Confiscatory, in so far as it May Apply to Transfers of the Kind Involved in This Case Even Though Made After the Passage of the Act; and is Therefore in Conflict With the Fifth Amendment.**

In *Nichols v. Coolidge* this Court left open the question whether the Revenue Act of 1918 is unconstitutional even as to subsequent transfers. The opinion of the Court concludes as follows:

> "Whether or how far the challenged provision"—*i. e.*, the provision that property transferred irrevocably by a decedent prior to his death shall be included in the taxable estate at its value at the time of the decedent's death merely because the conveyance was intended to take effect in possession or enjoyment at or after his

death—"is valid in respect of transfers made subsequent to the enactment we need not now consider" (274 U. S. 543).

We start with the proposition upon which the decision in *Nichols v. Coolidge* is based, that—

> "A statute purporting to tax may be so arbitrary and capricious as to amount to confiscation and offend the Fifth Amendment" (274 U. S. 542).

To show the "arbitrary and capricious" character of the present "tax," let us take a few illustrations. A man worth, say; $1,000,000 settles one-half of his fortune upon trust for himself for life, with remainder to a collateral relative, or strangers to his blood. The trustee by wisely retaining the original investments, or by wisely changing investments, succeeds in augmenting the trust estate, originally $500,000, to $4,000,000. The estate which the grantor retains does not increase in value. If the trust estate is included at its value at the time of the grantor's death, the tax under the Revenue Act of 1918 would be $542,500, and thus the estate which the grantor had reserved for his wife and family would be absolutely wiped out by circumstances over which he had no control whatsoever.

The recent Federal Revenue Acts have remained in force only a comparatively few years, but their constitutionality must be judged, of course, by supposing them to be, as they are on their face intended to be, permanent. For example, if the Revenue Act of 1918 would be valid as to a decedent who had made a transfer on the day after its passage, and was struck by lightning the next day, it would necessarily also be valid if the same decedent had lived for forty years afterwards. Conversely, if it would be invalid in the latter case, it must also be invalid in the former.

In other words, in order to determine whether the Act is arbitrary and capricious in character, we cannot take into account the fact that it remained in force for only a few years. It can't be valid for a brief period, and invalid after the lapse of a time.

According to its terms, if a man made a transfer in 1919, reserving the income to himself for life, but no power whatsoever over the property, the estate which he might leave, say, in 1950, would be affected by what the trustee had done during the intervening years.

It may be said that the provision is necessary to prevent evasion; but is it not true that all legitimate purposes of tax evasion may be accomplished by taxing only transfers made after passage of the statute in contemplation of death—that is, transfers made when death from some existing peril other than the natural frailty of the human body is anticipated in the "near future," and when such anticipation is the moving cause of the deed? As said by this Court in *Nichols v. Coolige*:

> "Undoubtedly, Congress may require that property subsequently transferred in contemplation of death be treated as part of the estate for purposes of taxation. This is necessary to prevent evasion and give practical effect to the exercise of admitted power, but the right is limited by the necessity" (274 U. S. 542).

If, in addition, property is taxed over which the decedent reserved dominion, as by a power of revocation, as the law undoubtedly does (*Reinecke v. Northern Trust Co.*, 278 U. S. 339), surely the requirements of the prevention of tax evasion would be met.

Finally, if it be necessary for the prevention of tax evasion to include property which the decedent had transferred, reserving the income to himself for life, the only reasonable way would be to make the tax depend upon the *then* value of the property, rather than its value as enhanced by subsequent circumstances over which the grantor had no control whatsoever.

The Revenue Act of 1918 provides that the value of the gross estate shall be determined by including the value *at the time of the decedent's death* of all property of which he has at any time, whether before or after the passage of the Act, made a transfer or created a trust intended to take effect in possession or enjoyment at or after his death:

"That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

* * * * * * * * * *

"(c) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust—(1) in contemplation of or (2) intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act), except in the case of *bona fide* sale for a fair consideration in money or money's worth. * * *"

Now, if property is transferred to a trustee upon trust for the grantor for life with remainders over upon his death, and the power to vary investments is given to the trustee, the question arises whether the value at the time of the grantor's death is to be computed with reference to the property which he transferred, or to the property which the trustee holds by change of investments, at the time of his death. In either event, the Act is equally arbitrary and capricious.

If the Act means that the property originally transferred is to be included at its value at the time of the decedent's death, irrespective of the fact that it has been sold by the trustee in the meantime,—and such is certainly what the act says—then the tax will be levied in respect of property which has passed entirely out of the hands not merely of the grantor, but of all those whom he intended to benefit, so that perhaps for years before his death neither he nor they had any interest whatsoever in it.

For example, suppose a deed of trust is made of certain stock worth at the time $10,000. The Trustee immediately exercises a power of sale, and invests the $10,000 thus obtained in bonds which are worth at the time of the grantor's death exactly the amount paid for them. But, suppose the stock of which the trust estate originally consisted greatly increases in value, and is worth at the time of the grantor's

death $500,000. Is a tax to be levied with respect to this $500,000, and thus completely wipe out the trust estate? Nothing could be more absurd or irrational. Yet such is certainly the literal language of the statute. The property which the testator transferred was the stock and not the bonds. The Act declares that the gross estate shall be calculated by including the value at the time of the decedent's death of all property of which he has at any time made a transfer or created a trust to take effect in possession or enjoyment at or after his death. The only property which he so transferred was the stock.

If on the other hand the taxable estate is to be computed by taking the value of the trust investments as they exist at the time of the testator's death—as was assumed in *Frew v. Bowers,* 12 Fed. (2d) 625, 628, (2nd C. C. A., June 1, 1926), and made the basis for concluding that the Act is unconstitutional—the result is equally arbitrary and capricious. In *Frew v. Bowers,* just cited, the property had increased in value by prudent reinvestments by the trustee from $200,000 at the time of the transfer to $500,000 at the time of the grantor's death. Where the grantor reserves no power to control the investments, his estate is thus to be taxed by reason of circumstances over which he had no control and from which he could derive no benefit. Could anything be more arbitrary and capricious?

Judge Hough in *Frew v. Bowers,* said:

> "A tax on a transfer by A, but measured by anything other than the estate of A, may be a duty or excise in form, but it is a palpable effort to tax something other than the transfer" (12 Fed. (2nd) 625, 628).

When it is borne in mind that the Act of 1918 is by its terms a permanent enactment intended to last for an indefinite period, it will be seen that all the circumstances which this Court mentioned as showing the "arbitrary, whimsical and burdensome character of the challenged tax" would apply as well to subsequent transfers as to transfers previously executed.

This Court said in *Nichols v. Coolidge*, 274 U. S. 531:

> "An excise is prescribed, but the amount of it is made to depend upon past lawful transactions, not testamentary in character, and beyond recall. Property of small value transferred before death may have become immensely valuable, and the estate tax, swollen by this, may leave nothing for distribution. Real estate transferred years ago, when of small value, may be worth an enormous sum at the death. If the deceased leaves no estate there can be no tax. If, on the other hand, he leaves ten dollars both that and the real estate become liable. Different estates must bear disproportionate burdens determined by what the deceased did one or twenty years before he died" (274 U. S. 542).

If the Act had been limited to transfers made within some reasonable period anterior to the grantor's death—say, one or two years—a somewhat different question would have been raised. But applicable as the Act is, not merely to such transfers made within a reasonable time prior to his death, but to all transfers made after its enactment, whether made within one, or ten, or twenty, or thirty years before death, it is submitted that the provision is "so arbitrary and capricious as to amount to confiscation and offend the Fifth Amendment."

The only reason for holding the tax valid as to transfers made after its passage which does not apply to transfers made before it became effective, is that in the former case both the grantor and the grantees know that the transferred estate at its value at the time of his death will be included as part of his taxable gross estate. But what good does it do them to know this? They cannot foretell what the value will then be, or what estate the grantor may leave. Therefore, nobody can in any possible way compute what the tax will be. They cannot even tell whether there will be any tax. They are in quite as bad a fix as if there had been no estate tax law in effect; for even then they would know, of course, that Congress might pass such an act.

This makes the arbitrary character of the statute still more apparent. If property which was transferred by an irrevocable transfer, and which is absolutely vested (subject to an equitable life estate in the grantor) is to be taxable or not according to whether the grantor subsequently has successes or reverses in business, then indeed you have a tax laid by chance rather than according to any conceivable rule of reason. It would be just as sensible to say that the liability to tax should be determined by flipping a coin or throwing a die.

Moreover, this Court has repeatedly held that the Federal Estate Tax is levied upon a transfer by death or upon an interest which ceased by reason of death.

Y. M. C. A. v. Davis, 264 U. S. 47, 50;
Edwards v. Slocum, 264 U. S. 61, 62-3;
Greiner v. Lewellyn, 258 U. S. 384, 387.

This being true, how can the tax be constitutionally imposed on the full value of transferred property although the only interest which the decedent reserved and the only interest which came to an end with his death was a remote contingent interest infinitesimal in value in comparison with the value of the whole property transferred?

The recent decision of this Court, upholding the Gift Tax provisions of the Revenue Act of 1924, as applied to gifts made after the passage of the Act (*Bromley v. McCaughn*, 280 U. S. 124) may be thought to have some adverse bearing; but in point of fact it only brings into sharper relief the vice in Section 402 (c) of the Revenue Act of 1918. Both laws, indeed, "tax" gifts; but there the resemblance stops. The amount of the Gift Tax was fixed at the time of the gift, and was measured by the value of the property given, and by its value at that time. But the provision now challenged grades the rate of tax according to purely fortuitous circumstances—namely, the amount of other property which the donor may happen to own at the time of his death. Moreover, the rate of tax is fixed not by the value of the property given—nor even by

the value of the donor's remaining property—*at the time of the gift*, but by values at some date in the perhaps remote future, and by values affected by the character of management—prudent or imprudent re-investments—in the meantime.

## III.

**Mrs. May's Deeds of Trust Were Present, Outright Transfers and Were Not Intended to Take Effect in Possession or Enjoyment At or After Her Death Within the True Construction of the Revenue Act of 1918.**

We trust we have demonstrated that Sec. 402 (c) of the Revenue Act of 1918, in so far as it undertakes to exact estate tax in respect of Mrs. May's transfers, irrevocably executed before the passage of that Act, on the ground that they were to take effect in possession or enjoyment at or after her death, are unconstitutional under the decisions of this Court. At all events, it can hardly be denied that the foregoing contentions raise "a grave constitutional question." And of course, as every law-student knows, if there is any reasonable way, by construction or otherwise, of avoiding the decision of "a grave constitutional question," this Court conceives it its duty to adopt it.

United States v. Del. & Hudson Co., 213 U. S. 366, 407-8;
Lewellyn v. Frick, 268 U. S. 238, 251;
Missouri Pac. R. R. Co. v. Boone, 270 U. S. 466, 471-2.

Indeed, in *Reinecke v. Northern Trust Co.*, 278 U. S. 339, 348-9, this Court held that this very constitutional question is such "a grave constitutional question" as to necessitate any reasonable construction of the Statute in order to avoid its decision.

We shall now endeavor to show that it is quite unnecessary to decide any constitutional question, because the transfers here involved are not within the Revenue Act of 1918, Sec. 402 (c), properly construed.

### *Tranfer Not Taxable Merely Because Remainders to Children Are Limited to Vest in Possession After Grantor's Death.*

The learned Judge of the District Court* rested his decision squarely on the ground that if a deed of trust contains such limitations that estates in remainder are bound to vest in possession after the death of the grantor, then the whole deed is deemed to be intended to take effect in possession or enjoyment at or after the grantor's death, even though the grantor reserved no interest in, or benefit from, the property during his lifetime. He said:

> "It is certainly true, that the property covered by the gift included in the gross estate, came into possession or enjoyment of the donees only after the death of the donor. It seems to be settled by the authorities that the phrase 'to take effect in possession or enjoyment at or after death,' is used to designate a situation in which the donee's rights with respect to the property (as distinguished from an estate or interest in the property) change at, or after, and because of, the donee's death. It is perfectly clear that the donor by adopting a trust form of conveyance, manifested her intention that the property should not come into the present possession of the beneficiaries. By providing in effect for the termination of the trust after death, the possession is made to take effect at that time. While it is true that the trust may be said to take effect in enjoyment at once, the settlor by imposing the trust has made a transfer of the corpus, which not only was intended to, but actually does, take effect in possession after death. From its very nature a trust deprives the beneficiaries of possession as long as the trust continues." (R. 34-5.)

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* It should be added that the learned Judge of the District Court in his opinion cites the case of *Shukert v. Allen*, 6 Fed. (2d) 551, in the Circuit Court of Appeals (R. 36), but seems unaware of the fact that this decision had been reversed by this Court in *Shukert v. Allen*, 273 U. S. 545. Strange too, he cites *Nichols v. Coolidge*, 4 Fed. (2d) 112, in the District Court (R. 37), but seems unaware of the fact that this judgment had been reviewed by this Court on writ of error. *Nichols v. Coolidge*, 274 U. S. 531. It is also strange that Judge Thomson, although he cites cases in sundry State Courts as to State statutes, nowhere mentions the opinion of the Circuit Court of Appeals for the Eighth Circuit in *Reinecke v. Northern Trust Co.*, 24 Fed. (2d) 91, which was later affirmed, so far as material to the present case, by this Court. Nor does he cite or refer to the decision of Judge Rose in *Curley v. Tait*, 276 Fed. 840, 842, a case which was absolutely on all fours with the case at bar.

And again, later on in his opinion, he says:

> "The persons who were to take the corpus could not be determined until after the founder's death. How could it be said, therefore, that either the property or an interest therein is in possession or enjoyment at a time when the person who is to own the property is not ascertained"? (R. 37.)

Now, of course, it is obvious that this reasoning is altogether inconsistent with the decision of this Court in—

Reinecke v. Northern Trust Co., 278 U. S. 339.

That case involved five irrevocable trusts, in all of which it was provided that the corpus should not come into the possession of the beneficiaries until after the grantor's death. Some of them provided for accumulation of the income in whole or in part during the grantor's lifetime (see report of same case in the lower Court, 24 Fed. 2d 91, 92), and some of them provided that some or all of the income should be paid to beneficiaries during the grantor's lifetime, though the corpus was not to come to them until after her death. This Court said:

> "But the question much pressed upon us remains, whether, the donor having parted both with the possession and his entire beneficial interest in the property when the trust was created, the mere passing of possession or enjoyment of the trust fund from the life tenants to the remaindermen after the testator's death, as directed, and after the enactment of the statute, is included within its taxing provisions. That question, not necessarily involved, was left unanswered in *Shukert v. Allen*, 273 U. S. 545. There the gift of a remainder interest, having been made without reference to the donor's death, although it did in fact vest in possession and enjoyment after his death, was held not to be a transfer intended to take effect in possession or enjoyment at or after the donor's death, and for that reason not to be subject to the tax. But here the gift was intended to so take effect, although the transfer which effected it preceded the death of the settlor and was itself not subject to the tax unless made so by the circumstances that the possession or enjoyment passed as indicated." (278 U. S. 347.)

Again, this Court said:

> "One may freely give his property to another by absolute gift without subjecting himself or his estate to a tax, but we are asked to say that this statute means that he may not make a gift *inter vivos*, equally absolute and complete, without subjecting it to a tax if the gift takes the form of a life estate in one with remainder over to another at or after the donor's death. It would require plain and compelling language to justify so incongruous a result and we think it is wanting in the present statute." (278 U. S. 347.)

After this authoritative interpretation of the law, it is obvious that the foundation of Judge Thomson's opinion is cut away, and that the superstructure must fall.

Under such circumstances it would be a waste of time to discuss decisions of State Courts construing State statutes which were relied upon by Judge Thomson in the Court below (R. 36). We may remark in passing, however, that one patent fallacy in attempting to apply State cases as authorities upon the construction of the Federal statute is that the State cases related to taxes upon the several estates or legacies, whereas the Federal Tax is on the estate as a whole. In other words, if a statute taxes the transfer of any individual estate which vests in possession after the grantor's death, it may plausibly be contended that where a remainder is to vest in possession after death, the remainder must be taxable, though supported by a particular estate which vested in the grantor's lifetime; but where the tax is laid upon the passing of the estate as an entirety, it makes absolutely no difference to whom it goes so long as it passes from the grantor, and the shifting of estates in the property from one person to another is quite immaterial.

The distinction made in the last paragraph is not the technical distinction between a tax on the right to transmit and a tax on the right to receive, but between a tax on the transfer (or receipt) of the estate as a whole and a tax on the transfer (or receipt) of particular legacies, shares or estates.

The late Judge John C. Rose in *Curley v. Tait*, 276 Fed. 840, one of the earliest cases construing the Federal estate tax laws, a case practically identical on the facts with the case at bar, with that legal perspicacity which was so characteristic of him, anticipated the decision of this Court in *Reinecke v. Northern Trust Co.*, 278 U. S. 339, saying:

> "If all beneficial ownership and possession irrevocably passes from the transferor at the time of the transfer, it would seem to be immaterial whether it goes to one person or to several, and, if to several, whether their enjoyment is to be simultaneous or successive, and, if the latter, at what time or upon the happening of what event the rights of one give place to those of the other" (276 Fed. 842).

*The Reservation of a Contingent Life-Estate in Remainder.*

The only possible distinction between the present case and *Reinecke v. Northern Trust Co.* is that here a contingent equitable life estate was reserved to the grantor if she should survive her husband, Barney May,—an event which never happened—whereas in *Reinecke v. Northern Trust Co.* nothing was reserved to the grantor beyond a power to alter the trusts with the consent of all or a majority of the beneficiaries, and a power to supervise the investment of the trust funds and vote the trust stocks.

Now we have the simple case where a woman settles property upon trust for her husband for his life with remainder to herself for her life if she should survive him, and after her death to her children or their issue. In order to support the decision below the Government must contend that the reservation of this contingent life estate to the grantor, a reservation which never came into effect and from which she never derived the least benefit, nevertheless makes *the entire transfer* taxable.

In this connection, when we speak of the equitable life estate in remainder reserved to Mrs. May as "contingent," we are not using that word in the sense in which it is used in the law of real property. Technically, no doubt, the

remainder was vested, as the only contingency was the termination of the preceding estate before the expiration of the life estate in remainder. But tax laws are practical matters, and do not regard the technicalities of the feudal law of real property. For all practical purposes, Mrs. May's estate in remainder was a contingent one, and of very problematical value. So, where property is limited to A for 2,000 years, remainder to B for life, remainder to C in fee, the remainder to B is technically vested, but not even an antediluvian patriarch could have the remotest hope of ever enjoying it, and it could not be sold for the tenth part of a peppercorn.

Under Section 402 (c) of the Revenue Act of 1918, that which is to be included in the gross estate is "any interest * * * of which the decedent has at any time made a transfer or with respect to which he has at any time created a trust * * * intended to take effect in possession or enjoyment at or after his death"—that is to say, "any interest" of which the decedent has reserved to himself the benefit during his life.

As demonstrated by *Reinecke v. Northern Trust Co.*, 278 U. S. 339, an "interest" in property is transferred, or setlted in trust, so as to take effect in possession or enjoyment at or after the grantor's death, only when the beneficial enjoyment of that "interest" is reserved to the grantor during his life. It is immaterial that a remainder can vest in possession only after the grantor's death if it is supported by a particular estate which vests in possession during his lifetime.

Now, in the ordinary case where the grantor reserves to himself *a certain proportion* or *part* of the income for his life, it is quite clear that the "interest" which is settled to take effect in possession or enjoyment after his death, is the *same proportion,* or *corresponding part* of the principal. This has been consistently recognized by the Treasury Regulations:

"Where the grantor reserves a proportionate part of the income, only a corresponding proportion of the property should be included in the gross estate, unless the transfer was made in contemplation of death. If, for example, he reserves one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserves an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. Where the property does not produce income, its value as of the date of the decedent's death should be ascertained, and so much of this sum as is necessary to produce the annuity should be included in the gross estate."

Regulations 37, Art. 24 (as to the Act of 1918).

*Cf.* Regulations 63, Art. 19 (as to the Act of 1921); Regulations 68, Art. 18 (as to the Act of 1924); Regulations 70, Art. 18 (as to the Act of 1926).

Where the reservation is of some *definite proportion,* or some *fixed part—e. g.,* an annuity—of the income, the computation is comparatively easy, and the case perfectly clear. If the grantor reserves one-half of the income during his life, the "interest" which the grantor has transferred in such a way as to take effect in possession or enjoyment after his death is one-half of the corpus. If the grantor reserves an amount of $10,000, the "interest" so settled is so much of the corpus as will produce a net income of $10,000 a year.

If the reservation is of some trivial or insignificant right, not affecting in any substantial degree "the economic benefits or enjoyment of the property," it may be wholly disregarded. This is demonstrated by *Reinecke v. Northern Trust Co.,* 278 U. S. 339, where this Court held that the reservation to the grantor of a right to control the trust investments, and to vote the trust stocks, during his life, and even to alter the trusts with the consent of a majority of the *cestuis que trust,* is immaterial.

On the other hand, if the entire income is reserved to the grantor subject only to some absurdly improbable contingency — for example, unless the independence of the United States shall cease — we suppose no one would doubt but that the contingency should be disregarded and the transfer as a whole held to take effect in possession or enjoyment after the grantor's death.

In the present case, the whole income was in a certain contingency — which never happened — reserved to the grantor. She never in fact received any benefit from the reservation, and she had but a slim chance of ever doing so—how slim we do not know.

The record does not disclose the age of either Mrs. Pauline May, the grantor, or Barney May, her husband, so that we can not compute by any mortality tables the value of the chance that Mrs. May might survive her husband.

The contingent and problematical benefit reserved to Mrs. May was even more illusory, uncertain and negligible as a reservation of "economic benefits and enjoyment of the property" than the reservation of a right to control investments and to vote in respect of the trust stocks, both of which were held immaterial in *Reinecke v. Northern Trust Co.*, 278 U. S. 339.

Three views are possible, indeed, in such a case as the present, as it would seem to us:

1. That in view of the uncertain and problematical character of Mrs. May's reserved equitable life estate in remainder, it should be disregarded for Federal tax purposes.

2. That regard should be had to the events which have happened, so that if Barney May had predeceased his wife and she had come into enjoyment of her equitable life estate, then the transfer should be deemed to have taken effect in possession or enjoyment at or after her death, but that in the events which have actually happened in the present case, no tax in respect of this transfer should be imposed.

3. That the Court should endeavor to calculate by reference to mortality tables the value of Mrs. May's equitable life estate, and treat as taxable, at its value at the time of her death, that portion of the trust property a present estate in which for Mrs. May's life would, at the time of the execution of the deed, have equalled the value of her contingent life estate in remainder in the whole.

The third of these alternatives seems to have been that preferred by Judge Rose in *Curley v. Tait,* 276 Fed. 840, 842, but all that he *decided,* on this branch of the case, was that the reservation of the contingent life estate in remainder did not render the *whole property* taxable. At all events, this Court has said that mathematical formulas are, if possible, to be avoided in matters of taxation, and the complexities of any such method would seem to us to render preferable one or the other of the other two possible views above mentioned, both of which lead to the same result on the facts of this case.

As laid down in *Reinecke v. Northern Trust Co.,* if Mrs. May had not in her lifetime "any control over the economic benefits and enjoyment of the property" (278 U. S. 346), no part of the trust property is taxable. The tax is imposed upon the shifting of the economic interests in the trust property (*ibid.*); and the question is whether in any proper sense of the word Mrs. May could be held to have had during her lifetime "any control over the economic benefits and enjoyment of the property," or whether there could be held to have been upon her death any real passing of the economic interest in the property from her. It would seem that the contingent life estate reserved to Mrs. May was too uncertain and illusory in character to be regarded at all, particularly in view of the fact that Mrs. May predeceased her husband, so that this estate never actually came into possession or enjoyment. In the events which have happened, Mrs. May parted with the entire estate as completely as if she had made an outright deed of the same. From the day of the execution of the deed she never had one particle of

beneficial interest or enjoyment in the property. She derived no economic benefit from the same.

If it be said that it is impossible to determine whether Mrs. May reserved any substantial benefit, and if so how much, the result would be that the transferred assets should not be included in the gross estate. For, the rule, of course, is well-settled that *prima facie*, a citizen is free from tax, and that in order to hold him liable to tax all doubts must be resolved in his favor.

Reinecke v. Northern Trust Co., 278 U. S. 339, 348;
Gould v. Gould, 245 U. S. 151, 153;
United States v. Merriam, 258 U. S. 179, 187.

*It is Unnecessary Now to Determine How Much, if Any, of the Trust Property Should Be Included in the Gross Estate.*

The Commissioner of Internal Revenue included the whole value of the trust property in the gross estate, and the Government assessed and collected a tax accordingly. If *any part* of that value ought not to have been included in the taxable estate, the tax so collected was excessive, and the plaintiffs were entitled to recover something.

At the present time, therefore, all that it is necessary for the Court to decide is that the whole value of the transferred property cannot lawfully be included in the taxable estate. If the tax on any portion of that value was improper, it was error to strike out the statement of claim, and thus, in effect, sustain a demurrer thereto. In *Curley v. Tait*, 276 Fed. 840, 842, already cited, Mr. Grafflin, had made a deed of trust in trust for his wife for her life, with remainder to himself for his life, and with ultimate remainder in fee to a charity. The case arose on demurrer to the declaration; and Judge Rose, after pointing out that the utmost which could be taxed was that interest, if any, in the property of which the grantor retained the benefit during his life, and

after pointing out the difficulty in calculating the amount of that interest, particularly in view of the fact that in the events which had happened he actually had no benefit from the trust property during his life, said:

> "At the hearing the government was so confident that it was entitled to tax the full value of his interest, and the plaintiff so certain that none of it should be taxed, that neither of them discussed the question now mooted. As from what has been said it follows that the entire interest was not taxable, the demurrer to so much of the plaintiff's declaration as seeks to recover the tax exacted on all of it must be overruled. The question of whether the government was entitled to any part of the tax less than the whole need not be passed upon, and should not be, until the Court is enlightened by further argument" (276 Fed. 842).

We submit, therefore, that *beyond doubt,* under the decision in *Reinecke v. Northern Trust Co.,* this transferred property cannot, to the extent of the full value thereof, be treated as property of which Mrs. May made a transfer to take effect at or after his death, and that *at most* only that proportion of the trust property a life estate in which at the time of the execution of the deed, for a woman of Mrs. May's age, would have been equal in value to a contingent life estate in the whole to a person of her age, expectant upon the determination of a preceding life estate to a person of the age of her husband.

The decision of the Circuit Court of Appeals in the present case was rendered on January 9, 1929. The brief *per curiam* opinion states merely "this case is distinguishable from *Nichols v. Coolidge,* 274 U. S. 531, on the facts" (R. 41), but makes no mention of *Reinecke v. Northern Trust Co.,* which had been decided in the Circuit Court of

Appeals some months before, and must have been pending in this Court when the present case was argued below. In fact, *Reinecke v. Northern Trust Co.* was decided by this Court exactly one week before the Circuit Court of Appeals announced its decision in the present case, and on motion for a reargument, the decision of this Court in the Reinecke Case was strongly pressed on the Circuit Court of Appeals, but without avail. It is a matter of common knowledge, however, that on motion for a reargument a Court is apt to exercise the Christian virtue of perseverance, and it is therefore not incomprehensible that the Circuit Court of Appeals should adhere to a decision which seems to us to ignore a controlling decision of this Court.

It is not surprising, therefore, that Judge Dickinson, in the District Court for the Eastern District of Pennsylvania, has refused to follow the decision of his own Circuit Court of Appeals in the case at bar, on the ground that it is inconsistent with the decisions of this Court in *Nichols v. Coolidge*, 274 U. S. 531, and *Reinecke v. Northern Trust Co.*, 278 U. S. 339.

Carnill v. McCaughn, 30 Fed. (2d), 696, 699.

We are confirmed in the belief that the decision of the Court below is inconsistent with the decision of this Court in *Reinecke v. Northern Trust Co.*, 278 U. S. 339, by the fact that the learned counsel for the Government in their brief in the Circuit Court of Appeals, filed before the decision of this Court in *Reinecke v. Northern Trust Co.*, conceded that the decision of that case would in all probability control this case. The brief stated:

> "The attention of the Court is called to the fact that the issue presented by the present case will probably be settled by the decision of the Supreme Court in *Reinecke, Collector, v. The Northern Trust Co.*, * * *. It seems likely the decision of the Supreme Court in this case will largely if not entirely settle the contention now existing between taxpayers and the Government relative to transfers of the character under discussion in the case at bar." (Brief for Appellee below, pp. 24-5.)

## CONCLUSION.

Upon the whole, therefore, we respectfully submit that on each and all of the three grounds above set forth, the judgment for the defendant should be reversed, and the cause remanded for further proceedings.

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